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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

In re: **LUKE'S LOCKER INCORPORATED, *et al.*,** **Debtors.**	**Case No. 17-40126** **(Jointly Administered)** **Chapter 11**

MOTION FOR AUTHORITY TO PAY PRE-PETITION WAGES AND OTHER EMPLOYEE-BENEFIT CLAIMS

NO HEARING WILL BE CONDUCTED ON THIS MOTION/OBJECTION/ APPLICATION UNLESS A WRITTEN OBJECTION IS FILED WITH THE CLERK OF THE UNITED STATES BANKRUPTCY COURT AND SERVED UPON THE PARTY FILING THIS PLEADING WITHIN TWENTY-ONE (21) DAYS FROM DATE OF SERVICE UNLESS THE COURT SHORTENS OR EXTENDS THE TIME FOR FILING SUCH OBJECTION. IF NO OBJECTION IS TIMELY SERVED AND FILED, THIS PLEADING SHALL BE DEEMED TO BE UNOPPOSED, AND THE COURT MAY ENTER AN ORDER GRANTING THE RELIEF SOUGHT. IF AN OBJECTION IS FILED AND SERVED IN A TIMELY MANNER, THE COURT WILL THEREAFTER SET A HEARING. IF YOU FAIL TO APPEAR AT THE HEARING, YOUR OBJECTION MAY BE STRICKEN. THE COURT RESERVES THE RIGHT TO SET A HEARING ON ANY MATTER.

TO THE HONORABLE BRENDA T. RHOADES,
CHIEF UNITED STATES BANKRUPTCY JUDGE:

NOW COMES Luke's Locker Incorporated ("LLI" or the "Debtor"), and hereby requests that the Court enter an order pursuant to 11 U.S.C. §§ 105(a), 363, 507(a)(4), 507(a)(5), and

541(d) authorizing payment of pre-petition wages to employees and other employee-benefit claims (the "Motion"). In support of the Motion, the Debtor respectfully states and represents as follows:

I. JURISDICTION AND VENUE

1. This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157. This matter concerns the administration of this bankruptcy estate; accordingly, this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O). Venue is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409. The predicates for the relief requested herein are 11 U.S.C. §§ 105(a), 363, 507(a)(4), 507(a)(5), and 541(d) and rule 6004 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

II. FACTUAL BACKGROUND

2. Before filing for bankruptcy protection, the Debtors[1] operated retail stores throughout Texas, known as Luke's Locker, that specialized in running and fitness apparel, footwear, and other related goods, with a particular focus on providing excellent customer service. They also provided training programs (running and walking) for its customers, and they helped sponsor and host numerous running and walking events throughout the year, including everything from charitable 5Ks to free weekly social runs from the stores. Luke's Locker is a recognized leader in its industry, having won numerous D Magazine Readers' Choice and Best of Big D awards throughout the years.

3. Luke's Locker's origins go back as far as 1970, when Don Lucas was a Dallas attorney and running enthusiast. The problem was that shoes specially designed for running were not generally available in Dallas at the time. So Mr. Lucas contacted a company in Oregon

[1] Debtors 2L Austin, LLC and The Quality Lifestyle I, LP (collectively with LLI, the "Debtors") are debtors in affiliated bankruptcy cases, though they no longer operate any stores.

called Blue Ribbon Sports. Blue Ribbon sold him shoes for his own use, and he, in turn, sold more of Blue Ribbon's shoes to fellow Dallas runners out of the trunk of his car. Blue Ribbon Sports officially changed its name to Nike, Inc. in May 1971.

4. Mr. Lucas's shoe business moved from the trunk of his car, to his garage, and eventually into the first Luke's Locker on Oak Lawn in Dallas. In addition to running shoes, Luke's Locker carries workout gear, sportswear, cross training shoes, track and cross country spikes, tennis shoes, and a host of related accessories. At the time of its bankruptcy filing, Luke's Locker had locations in Austin, Dallas, Fort Worth, Highland Village, Houston, Katy, Plano, Southlake, White Rock Lake, and The Woodlands along with a corporate office and a central distribution warehouse in Dallas.

5. Unfortunately, as is the case with the brick-and-mortar retail business in general, Luke's Locker suffers from undercutting online competition, though it nevertheless has a fiercely loyal customer base. Luke's Locker also undertook an aggressive expansion campaign in recent years, opening numerous new stores. This led to the Debtors entering into various leases that, with the benefit of hindsight, are more burdensome than the Debtors anticipated.

6. These problems and others combined to create a serious liquidity crisis. Luke's Locker turns over inventory quickly and with good margins. But without adequate liquidity, Luke's Locker had a harder and harder time acquiring inventory. And as Luke's began to fall behind with its principal vendors, those vendors began demanding cash in advance, further exacerbating the liquidity crisis. In spite of these problems, however, Luke's Locker still produced $34 million in revenue during the last fiscal year. So the Debtors sought protection under chapter 11 in order to reorganize their financial affairs and reemerge from bankruptcy free of the burdens that led to its current predicament

7. On January 24, 2017 (the "Petition Date"), the Debtors each filed a voluntary petition under chapter 11 of the Bankruptcy Code, thereby initiating the above-captioned, jointly administered cases. The Debtors continue to operate their businesses as debtors-in-possession under sections 1107 and 1108 of the Bankruptcy Code. The Court has not appointed a trustee or examiner in these cases.

8. As of the Petition Date, the only stores operating at full capacity were the Dallas and Fort Worth stores. After the bankruptcy filing, the Debtors permanently closed their Austin, Highland Village, Houston, Katy, Woodlands, and White Rock stores and ultimately rejected the store leases associated with those closed locations. The Debtors also closed their corporate office and will be rejecting their central distribution warehouse lease at the end of March 2017.

9. LLI currently intends to continue operating only its Dallas, Fort Worth, Southlake, and Plano stores, and it has just reopened its Plano and Southlake stores. But because those stores were closed on the Petition Date, LLI had already laid off the employees who worked there. Several of those employees have returned to work now that the stores have reopened, and they all had pre-petition wage claims against LLI.

III. RELIEF REQUESTED

10. By this Motion, LLI seeks entry of an Order under sections 105(a), 363, 507(a)(4), 507(a)(5), and 541(d) of the Bankruptcy Code authorizing it, in accordance with stated policies (as modified from time to time), to pay certain pre-petition obligations to the employees of its Plano and Southlake stores who have returned to work at those stores since they are reopened (the "Employees"). As more fully described below, these pre-petition obligations are for amounts owed for wages, salaries, and taxes attributable thereto; and (b) benefit claims of the Employees (including, without limitation, medical, holiday pay, other paid leave, 401(k) savings plans, and other similar programs or miscellaneous other benefits). In addition to providing

these benefits, LLI routinely makes deductions from the Employees' payroll relating to, for example, employee contributions to insurers, federal, state, and local tax withholdings, 401(k) savings plan, or other similar programs. Collectively, these items will be referred to as "Pre-Petition Compensation".

11. Pre-Petition Wages. LLI brought back a total of 6 prepetition Employees to operate its Plano and Southlake locations. The last pre-petition pay date for the Employees was Friday, January 13, 2016, and that payment paid Pre-Petition Compensation for December 26, 2016 through January 8, 2017. LLI makes payroll one week in arrears, so, as of the Petition Date, Pre-Petition Compensation owed to the Employees would be for services provided from January 9 through 22, 2017.

12. The Employees who are owed Pre-Petition Compensation and the amounts they are owed are as follows:

Employee	Pre-Petition Wages
Ben Theriault	$1,942.31
Susan Funk	$1,014.39
Lori Gillespie	$733.21
Orlando Dimas	$2,384.61
Sue Janosko	$2,500.00
Melissa Cook	$3,269.23

In the interest of full disclosure, LLI inadvertently paid these amounts on March 3, 2017 during the scramble to reopen the Plano and Southlake stores and due to a miscommunication regarding LLI's ability to pay these amounts. However, this pay is critical to each Employee, and delay in receipt of such pay by the Employee would have seriously impaired morale and jeopardized LLI's ongoing operations.

13. More importantly, LLI invested significant time and money to train each of the Employees. Luke's Locker is a highly specialized retailer, and its employees must be properly trained to meet customer needs and expectations. Paying the Employees' pre-petition wage claims was necessary to incentivize them to return to work, which ultimately saved LLI a significant amount of time and money that would have been wasted training completely new employees. Accordingly, LLI requests that the Court approve these payments retroactively.

14. Insurance Benefits. LLI requests authority to pay, from time to time, as and when due, certain pre-petition claims, premiums, and administrative expenses related to insurance benefits (collectively, the "Pre-Petition Benefits") for the Employees and their eligible dependents. LLI provides the Employees with medical insurance through a fully insured program offered through United Health Care (the "Plan"). LLI requests this Court's permission to pay all of its obligations under the Plan for the Employees that arose pre-petition and post-petition, if any, including the obligation to pay insurance premiums, without further Order from this Court. To the extent a premium payment is owed, the Debtor seeks authority from this Court to allow it to make such payments as are necessary to insure that prepetition claims of the Employees are honored and continued in force without interruption.

15. If the Pre-Petition Benefits claims of Employees are not paid, certain health-care providers could seek payment directly from the Employees and might refuse to provide continuing medical services or treatment to them. Permission to pay the Pre-Petition Benefits is particularly necessary for those Employees who currently are receiving services or who are recuperating from recent medical treatment. In addition, these employees might not receive disability-income (replacement) payments. The morale of the Employees would then be seriously undermined if medical benefits were interrupted. More importantly, however, the

Debtor wants to avoid the risk that the Employees will not be given needed treatment because health-care providers have not been paid for pre-petition services. Therefore, the Debtor requests authority to take all steps necessary to reinstate medical benefits for the Employees as necessary.

16. Payroll Deductions. As with other major corporations, certain of the benefits offered by the Debtor to the Employees, such as insurance, involve payroll deductions as Employee co-contributions or otherwise. In such cases, the Debtor deducts certain amounts from an Employee's payroll check and subsequently pays those funds, along with any required employer co-contributions, to the appropriate third party. The Debtor also routinely and ordinarily makes deductions from the Employees' payroll relating to federal, state, and local-tax withholdings, employee-savings programs, charitable-contributions, garnishments, and other similar programs. The Debtor requests authority to pay over to the appropriate parties all such funds in accordance with existing company policies and practices.

IV. BASIS FOR REQUESTED RELIEF

17. The Debtor believes that the majority, if not all, of the amounts covered by this Motion are entitled to priority-claim status under sections 507(a)(4) and 507(a)(5) of the Bankruptcy Code.

18. Section 507(a)(4) of the Bankruptcy Code grants employees priority claims for:

> allowed unsecured claims, but only to the extent of $10,000 for each individual or corporation, as the case may be, earned within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for— wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor's business if, and only if, during the 12 months preceding that date, at least 75 percent of the amount that the individual or corporation earned by

> acting as an independent contractor in the sale of goods or services was earned from the debtor. 11 U.S.C. § 507(a)(4).

Likewise, under section 507(a)(5) of the Bankruptcy Code, employees are granted a priority claim under the following circumstance(s):

> allowed unsecured claims for contributions to an employee benefit plan (a) arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only (b) for each such plan, to the extent of — (i) the number of employees covered by each such plan multiplied by $10,000; less (ii) the aggregate amount paid to such employees under paragraph (4) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan. 11 U.S.C. § 507(a)(5).

19. As such, these claims would be entitled to payment in full under any chapter 11 plan. Authorizing the Debtor to make these payments at this time will affect only the timing of such payments. To the extent that such claims are not entitled to priority-claim status, its payment is justified under the "doctrine of necessity."

20. In so justifying, courts have used section 105(a) of the Bankruptcy Code, which codifies the equitable powers of bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]," to authorize the post-petition payment of employee claims like those noted herein to preserve the debtor's going-concern value. *See Miltenberger v. Logansport, Crawfordsville and Southwestern Ry. Co.*, 106 U.S. 286, 311 (1882) (holding that "[m]any circumstances may exist which may make it necessary and indispensable to . . . the preservation of the property, for the receiver to pay pre-existing debts of certain classes out of the earnings of the receivership); *see also Mich. Bureau of Workers' Disability Comp. v. Chateaugay (In re Chateaugay Corp.)*, 80 B.R. 279, 285-87 (S.D.N.Y. 1987) (finding that a court's equitable powers include authorizing a debtor to pay prepetition debts). As such, a bankruptcy court's use of its equitable powers to "authorize the

payment of pre-petition debt when such payment is needed to facilitate the rehabilitation of the debtor is not a novel concept." *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989) (citing *Miltenberger*, 106 U.S. at 311).

21. The bankruptcy court's exercise of its authority under the "doctrine of necessity" is appropriate to carry out specific provisions of chapter 11—sections 1107(a), 1108 and 363(b)(l) of the Bankruptcy Code—that authorize a debtor in possession to maintain and to operate the debtor's business and use estate property outside of the ordinary course of business. Indeed, a debtor in possession operating a business under section 1108 of the Bankruptcy Code has a duty to protect and to preserve the going-concern value of an operating business, and pre-petition claims may be paid if necessary to perform the debtor's duty. *See In re CoServ, L.L.C.*, 273 B.R. 487, 497 (Bankr. N.D. Tex. 2002) ("There are occasions when this duty can only be fulfilled by the preplan satisfaction of a prepetition claim."). A bankruptcy court's exercise of its authority under section 105(a) of the Bankruptcy Code is also appropriate to carry out two central policies underlying Chapter 11: (a) to permit the successful rehabilitation of the debtor and (b) to preserve going concern value and maximize property available to satisfy all creditors.

22. Finally, to the extent funds are held in trust by the Debtor, those funds are not property of the bankruptcy estate under section 541(d) of the Bankruptcy Code, which excludes "property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest." 11 U.S.C. § 541(d). It is well established under section 541(d) of the Bankruptcy Code that taxes collected on behalf of taxing authorities are not property of the estate. *Begier v. IRS*, 496 U.S. 53, 59 (1990) (holding that taxes such as excise taxes, FICA taxes, and withholding taxes are property held by the debtor in trust for another and, as such, are not property of the estate); *see also Old Republic Nat'l Title Ins. Co. v. Tyler (In re Dameron)*,

155 F.3d 718, 721 (4th Cir. 1998) (holding that deposits subject to an express trust are excluded from the bankruptcy estate); *City of Farrell v. Sharon Steel Corp. (In re Sharon Steel Corp.)*, 41 F.3d 92, 98-103 (3d Cir. 1994) (holding that funds withheld from employee's paychecks may be subject to a trust and, thus, are not property of the debtor's estate, even when such funds are commingled with the debtor's other property). Here, amounts withheld and deducted from Employee's checks (as noted above) are funds held in trust by the Debtor for the benefit of another.

23. The relief sought herein is essential to the success of the Debtor's chapter 11 case. Here, to achieve success, it is critical that the Employees be paid without interruption and that the Debtor continues to honor its existing practices and policies for the pecuniary benefit of the Employees. Such payments are necessary to prevent irreparable harm to the morale of the Employees at the very time when its dedication, confidence, and cooperation are vital to this case.

V. PRAYER

BASED UPON THE FOREGOING, the Debtor requests that this Court enter an Order (a) authorizing payment of Pre-Petition Compensation to the Employees and other employee-benefit claims, including but not limited to the March 3, 2017 payments already made; and (b) awarding the Debtor such other and further relief that this Court deems just and proper.

Dated: March 20, 2017.

Respectfully submitted,

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COUNSEL FOR THE DEBTOR

CERTIFICATE OF SERVICE

This is to certify that on March 20, 2017, a true and correct copy of the above and foregoing document will be served by electronic filing, email, facsimile or US Mail First Class Postage Paid to the parties on the attached service list.

/s/ Melissa S. Hayward
Melissa S. Hayward